Service Date: September 26, 1991

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application of the City of Great Falls for Authority to Increase Rates and Charges for Water Service to its Great Falls, Montana, Customers.	UTILITY DIVISION DOCKET NO. 90.10.67 ORDER NO. 5523f

APPEARANCES

FOR THE APPLICANT:

David Gliko, City Attorney, City of Great Falls, P.O. Box 5021, Great Falls, Montana 59403-5021.

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34 West 6th Avenue, Helena, Montana 59620.

Lt Col Bruce Barnard, Attorney-at-Law, Federal Executive Agencies, HQ USAF/ULT, Stop 21, Tyndall AFB, Florida 32403-6001.

Robert Goff, Attorney-at-Law, Montana Refining Company, Third Floor, Norwest Bank Building, P.O. Box 1645, Great Falls, Montana 59401.

Patrick Flaherty, Attorney-at-Law, Montana Peoples Action, 625 Central Avenue West, Great Falls, Montana.

FOR THE COMMISSION:

Tim Sweeney, Staff Attorney, 2701 Prospect Avenue, Helena, Montana 59620.

Ron Woods, Rate Analyst, 2701 Prospect Avenue, Helena, Montana.

BEFORE:

BOB ANDERSON, Commissioner and Presiding Officer
JOHN DRISCOLL, Commissioner
WALLY MERCER, Commissioner

BACKGROUND

1. On November 5, 1990, the City of Great Falls (Applicant

or City) filed an application with this Commission for authority to permanently increase water rates for its Great Falls, Montana, customers by approximately 45.2%, which constitutes an annual revenue increase of approximately $1,591,100.

2. Concurrent with this filing for a permanent increase in rates, the City filed an application for interim rate relief. The City requested an interim increase in rates of 26.4%, equalling a revenue increase of approximately $927,800 or 58% of the proposed permanent increase.

3. On November 28, 1990, the Commission, having considered the testimony and exhibits submitted by the City in support of its interim rate application issued Order No. 5523 granting the City interim relief in the amount of $540,267.

4. During the course of this proceeding the Commission issued Order Nos. 5523a, b and c. These orders addressed procedural or legal issues pertinent to the proceedings.

5. On April 26, 1991, the City filed an amended petition for water rate increase with the Commission. The amended petition reduced the amount of the annual revenue increase requested by the City from $1,591,100 to $1,460,900.

6. On May 28, 1991, following issuance of proper notice a hearing was held in the Civic Center, Great Falls, Montana. For the convenience of the consuming public a session was held at 7:00 p.m., May 28, 1991, at the same location. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustment.

ANALYSIS AND FINDINGS OF FACT

7. At the public hearing the Applicant presented the testimony and exhibits of the following witnesses:

John Lawton, City Manager,
Erling Tufte, Public Works Director

Tim Magee, Finance Director
John Gallagher, Consulting Engineer
Jim Wright, Consulting Engineer
Chris Hosler, Consulting Engineer

These witnesses testified on the current financial condition of the water utility, the need for the proposed capital improvements, the estimated cost of the proposed capital improvements, the financing of proposed capital improvements, cost-of-service study and rate structure.

8. The Intervenors in this Docket presented the testimony of the following expert witnesses:

Frank Buckley, Rate Analyst, Montana Consumer Counsel
Jerome Mierzwa, Consultant, Federal Executive Agencies
Thomas Catlin, Consultant, Federal Executive Agencies

These witnesses testified regarding the current and projected financial statements of the water utility, proposed modifications to the City's cost-of-service study and rate design modifications.

9. Montana Peoples Action (MPA) and the Montana Consumer Counsel (MCC) presented the testimony and exhibits of 17 public witnesses during the course the hearing. The majority of these public witnesses expressed concerns about rate impacts on fixed income subscribers, the estimated cost of the long-term capital improvement program, the possibility that water utility funds had been transferred to other funds thus necessitating this increase and presented a petition with 4,300 signatures opposing the rate increase. Three of the public witnesses testified in support of the proposed increase in water rates indicating that, in their opinion, utility facilities were in need of capital maintenance.

CAPITAL IMPROVEMENT PROGRAM AND DEBT REPAYMENT

10. In prefiled testimony and exhibits the City set forth a proposed 10-year capital improvement program for the water utility. As outlined by the City the total estimated cost of the

10-year capital improvement program is $30,133,400 (Exhibit G.F. 5, p. 2-6). The stated cost of the capital improvement program was subsequently reduced for capital maintenance to fire hydrants (line 165, Appendix J, Water Master Plan) reflected as operation and maintenance expenses in late filed exhibits. The estimated cost includes the repayment of $2,550,100 borrowed from the City's central garage fund to finance capital improvements to the water system during FY 1990.

11. As presented in the documents filed with the Commission, the entire 10-year capital improvement program, and attendant funding, appears to be under consideration by the Commission in this Docket; however, that is not the case. The Commission's jurisdiction relative to the capital improvement program is defined by the City's rate increase application. The City's rate increase application requests that the Commission authorize revenues sufficient to service debt on capital improvements, including those financed with the central garage fund loan, during the two fiscal years subsequent to issuance of an order in this Docket. The City has limited its rate request to funding these items and, therefore, Commission authority to accept or reject all or part of the capital improvement program is confined to the improvements of that time period.

12. The City proposes that the majority of the capital improvements under consideration in this Docket be funded from a Revenue Bond issue having a term of 20 years and a maximum interest rate of 8.0 percent, with the requirement that the City have a reserve fund in an amount equal to one year's principal and interest payment on the bond, and that it provide debt service coverage of at least 125%.

13. The City's proposed water system improvement program is documented in detail in the Water Master Plan prepared by Black & Veatch (B&V), June 1990. City witnesses testified that the water system master plan documents a need for improvements to the following: treatment facilities, transmission facilities, storage and pumping facilities, and the distribution system.

14. Table 1 sets out the proposed costs, by operational function, associated with the capital improvements program.

TABLE 1

1. Treatment	$ 293,400
2. Transmission Mains	$ 698,800
3. Storage & Pumping	$ 795,400
4. Distribution Mains	$2,120,100
5. Extension & Oversizing	$ 583,800
6. Special Projects	$ 210,900
7. Capitalization of Reserve Fund	$ 718,100
Total	$5,420,500*

*Costs are 1992 and 1993 dollars

15. WATER TREATMENT. City witnesses asserted that the water treatment facility is in need of several retrofit-type capital improvements during the next two fiscal years. These electrical service improvements were not specifically contested by any party participating in this proceeding.

16. TRANSMISSION MAINS. The City proposes to construct two capital improvements during fiscal years 1992 and 1993 to correct deficiencies in its transmission facilities. The first is designed to improve the deliverability of water to the southwestern part of the city. The City's witnesses indicated that the transmission main delivering water to this part of the city is nearing capacity. The consulting engineers stated that the best way to improve water deliverability to this part of the city was to construct a new transmission main at an estimated cost of $3.3 million. However, due to the large costs associated with construction of a new main, the consultants developed an alternative. They proposed the installation of pressure reducing valves to deliver water from pressure zone 4 to pressure zone 1 as an intermediate procedure to enhance deliverability pending further development in that part of the city. The construction of a new main was contested by the public but the alternative was not. The estimated cost of installing the pressure reducing valves in 1992 is $80,000.

17. The second improvement to transmission facilities is

the reconstruction of the 20-inch main across the Missouri River to the northwest (the fairgrounds main). The City's witnesses indicated that this main is old and is a maintenance problem due to frequent breaks. The reconstruction of approximately 4,000 feet of this main is proposed to improve reliability and will cost approximately $618,800 in 1992. No specific resistance to this proposal was presented during the hearing.

18. STORAGE AND PUMPING. The City in its filing has proposed five improvements to its storage and pumping facilities at a total cost of $795,400 during fiscal years 92 & 93. $351,000 of the costs are for improvements designed to enhance the ability of the City to deliver water during periods of peak demand. $440,400 of the improvement costs are for preventive maintenance to storage facilities to maintain the integrity of these facilities.

19. DISTRIBUTION MAINS. The City witnesses testified that certain water distribution mains are approaching 100-years of age, particularly those in the central business district, and are in need of replacement. The witnesses also indicated that capacity problems are being experienced in five general locations within the existing distribution system.

20. The City's witnesses represented that the frequency of line breaks on the approximately 100-year-old mains are increasing and the reliability of the distribution system is at risk as a result. It was also represented that it would be more cost-effective to replace these mains rather than to continue maintaining them. B&V, in the master plan, states that distribution mains have a useful economic life of approximately 100-years. Therefore, B&V proposed that the City establish a 100-year main replacement cycle to correct the problem of old, deteriorated distribution mains. Based on leak frequency information maintained by City staff, the witnesses determined that the mains to be replaced during the next two fiscal years are clearly maintenance problems.

21. MPA objected to the City's goal of implementing a 100-year replacement cycle for distribution mains. MPA witnesses asserted that the proposition was too costly for the ratepayers. Rehabilitation of utility facilities represents an ongoing financial requirement of a utility operator if it is to provide reasonably adequate service and facilities to its subscribers. Assigning a 100-year useful economic life to distribution mains and implementing B&V's proposed main replacement program, cannot be termed an the Commission an unreasonable financial burden to impose on ratepayers.

22. City witnesses indicated that computer modeling and analysis revealed that pressure, capacity, and flow problems were being experienced in five specific areas of the existing distribution system. The FY 92-93 capital improvement program proposes construction projects for two of the five areas experiencing problems at an estimated cost of $207,250. Both of these improvement projects consist of the looping of water mains and are being constructed to remedy low pressures being experienced in the areas served. These improvements were not specifically contested.

23. EXTENSIONS & OVERSIZING. Appendix J of the Water Mater Plan indicates that the City proposes four construction projects during FY 92 & 93 under this category of improvements at an estimated cost of $583,800. An examination of the project descriptions under this heading leads the Commission to believe the category heading "Extensions & Oversizing" is a misnomer, at least for FY 92 & 93. The proposed construction projects appear to be replacements of existing distribution mains in conjunction with Montana Department of Highways road reconstruction. Coordinating with the Highway department affords the City the opportunity to improve the infrastructure at a lower cost to utility subscribers. Replacement of the utility facilities would also maintain the integrity of the newly reconstructed roadways by postponing the need for utility repairs in the area. The Commission's finds these improvements represent a coordinated effort between the City and the Highway Department and indicates

that the City is exercising reasonably good management practices in deciding to participate.

24. SPECIAL PROJECTS. Under this capital funding heading the City proposed five categories of special projects. During the hearing it was revealed that the City had proposed to duplicate funding of its fire hydrant maintenance program by including this funding as a capital expenditure under this heading and also as an operating expense. The City has withdrawn its proposal that fire hydrant maintenance be funded as a capital item.

25. The total estimated cost of capital expenditures for special projects is $210,900 during FY 92 & 93. Funds in this category will be expended on modernizing the city's lab, installing water meters, standpipe repairs and saddle replacements. The need for funding these items was not specifically contested.

26. DEBT REPAYMENT. During FY 1990 the water utility, with the approval of the City Commission, borrowed $2,550,100 from the central garage fund of the City to make repairs and improvements to the water system. The loan agreement provided that the loan would bear interest at the rate of 8.10% per annum until paid.

27. MRC questioned the City witnesses relative to the underlying rationale for the execution of a loan agreement between City funds and the associated interest cost. MRC's cross-examination of City witnesses revealed that MRC was of the opinion that the loan proceeds should not have to be repaid to the central garage fund. MRC established that the City's central garage fund was a discretionary fund created by the City Commission to accumulate a capital reserve for vehicle and equipment replacement. MRC further established that various City departments participate in the funding of this reserve. MRC therefore, asserted that the discretionary nature of this fund should afford the City the ability to spend the monies in the reserve for improvements to utility facilities without a

repayment obligation.

28. MRC's assertion that the City can, at its discretion, expend funds collected from various city departments on utility improvements is rejected by the Commission. Fiscal accountability, and the fact that the utility is to be self-supporting, requires the City to repay monies borrowed from the central garage fund.

29. City witnesses argued that the assessment of interest on the central garage fund loan was appropriate. Witnesses stated the funds in the reserve would have been invested and earned interest if the proceeds had not been loaned to the utility. The City witnesses explained that historically this reserve was invested in CD's, or some other secure investment, for the purpose of reducing assessments to the various departments. The assessment of interest on the monies borrowed from the central garage fund is found to be reasonable to the extent that the monies borrowed from the fund do not represent accumulated reserves of the utility.

30. The Commission finds, based upon the testimony in this Docket, that the FY 92 & 93 capital improvement program, as proposed by the City of Great Falls is prudent and therefore accepts the City's assertion that the improvements outlined in the filing need to be completed. The Commission further finds that repayment of the central garage fund loan with interest, except for interest on utility funds, is reasonable.

DEBT SERVICE

31. The City proposes to finance the capital improvements outlined in Table 1 of this Order, in part, through the issuance of revenue bonds. The City proposes to issue $7,050,000 in revenue bonds (amended from $7,300,000 presented in January, 1991) to be repaid over a period of 20 years with the requirements that the City capitalize from the bond proceeds a reserve fund in an amount equal to one year's principal and

interest payment on the bonds and provide a debt service coverage of 125 percent.

32. The Applicant has a current outstanding water revenue bond with an annual principal and interest payment of approximately $1,169,000 and a present coverage ratio requirement of 125%. The City does not anticipate retiring this bond issue with the issuance of the proposed $7,050,000 revenue bond issue. Therefore, the City will be incurring bond payments that are additional to those described in the preceding Finding of Fact. Since the City will not be retiring the current outstanding revenue bond it will have to comply with the requirements outlined in the current Revenue Bond Ordinances regarding the issuance of additional revenue bonds.

33. In any sale of municipal bonds the purchasers of the bonds must be assured that their investments are secure. To provide this security the municipality makes a promise, called a covenant, to do certain things that will ensure that it will always be able to pay the bond's principal and interest as they come due. In this instance, the City proposes to include covenants agreeing to establish a bond reserve fund in an amount equal to one year's principal and interest payment on the bond, amounting to $718,100, and provide a debt service coverage ratio of 125 percent.

34. The Commission finds the bond covenants, establishment of a reserve fund and the 125 percent coverage ratio to be among the standard requirements for the issuance of revenue bonds and, therefore, accepts the requirements.

35. The Commission, therefore, finds the issuance of $7,050,000 in revenue bonds with a maximum term of 20 years and a maximum interest rate of 8.0 percent, with the requirements that the City establish a bond reserve in an amount equal to one year's principal and interest payment on the bonds and provide a debt service coverage of 125 percent, to be appropriate.

36. When the City completes the sale of the proposed revenue bonds it will incur an annual principal and interest payment on all outstanding revenue bonds of approximately $1,887,100. It will also incur the obligation of having a net operating income of at least $471,775 to meet the requirement that it achieve a 125 percent coverage ratio. To determine net operating income, operation and maintenance expense and debt service are subtracted from the total revenues of the utility. The required net operating income is calculated by multiplying the annual principal and interest payment on outstanding bonds by 25 percent ($1,877,100 x .25 = $471,775).

OPERATING REVENUES

37. The Applicant proposed test period operating revenues of $3,518,600. The MCC contested this proposal. MCC's expert witness, Frank Buckley, contended that the City's test period operating revenues should be increased by $38,000 to allow for:

1) Increasing "Public Fire Hydrant Rental Charges" by $13,000 to reflect a rate change effective during FY 91.

2) Increasing normalized water sales revenue by $25,000 through use of 1990 census data and corrected treated water production information.

38. In late-filed exhibits submitted by the City June 11, 1991, the City adopted these proposed adjustments. With the City's acceptance of these proposed adjustments the Commission finds the test operating revenues of the utility to be $3,556,600.

39. The water utility will generate interest income through investment of its bond reserves. The Applicant calculated that it would generate approximately $89,000 in interest income on an annual basis. This calculation was reviewed and not contested by any party and is accepted by the Commission.

40. The Commission, based upon the preceding Findings of Fact, finds that the total test year revenues of the utility are

$3,645,600.

OPERATION AND MAINTENANCE EXPENSE

41. The Applicant proposed net test period operation and maintenance expenses of $2,678,000. The test period operation and maintenance expenses proposed by the Applicant are net of miscellaneous revenue.

42. The MCC proposed three adjustments to these expenses, decreasing the total by $196,020. The MCC's expert witness proposed the following adjustments:

(1) Decreasing the water utility's operating expenses by $48,075 to reflect an appropriate distribution of salary and wages of common employees of the water/sewer utility.

(2) Reducing expenses by $65,000 because sludge treatment expense has been reflected twice in the operation and maintenance expenses.

(3) Denying recovery of $82,945 in reported operating expenses associated with fire hydrant maintenance since that expense was already reflected in the capital maintenance budget.

43. During testimony at the hearing, and in late-filed exhibits, the City adopted MCC's proposed adjustment regarding sludge treatment expense. The Commission finds that the City has in fact double-reported this expense in its operating expenses, and that the proposed adjustment decreasing expenses by $65,000 is appropriate.

44. The City has agreed, in principle, with the MCC's proposal that a redistribution of salary and wages for common water/sewer utility employees is appropriate. However, it has not accepted that the expenses of the water utility should be reduced.

45. Utility operations of a local government are enterprise funds and as such should be self supporting. The City has indicated, in responses to data requests and in testimony, that

several employees in the public works department have common job responsibilities between the water and sewer utility operation. Consumers of the City water utility service should not be responsible for payment of expenses that are appropriately chargeable to the sewer utility. Therefore, the Commission finds that the expenses of the water utility should be decreased by $48,075.

46. The normalized test period operation and maintenance expense amount shown in Finding of Fact No. 41 does not include the proposed fire hydrant maintenance expense at issue between the MCC and the City. If the Commission agrees with the City that these expenses should be included it will represent an increase of $82,945. However, if the Commission agrees with the MCC the net effect on operation and maintenance expenses will be zero. Commission acceptance or rejection of this adjustment will have these effects because the Commission, for purposes of this order, is using the financial information filed in January, 1991, which forms the basis for the Applicant's amended revenue increase request filed April 26, 1991.

47. The MCC's witness Buckley in his testimony indicates that he is not convinced that the City has properly supported its contention that it omitted $82,945 in operating expenses associated with fire hydrant maintenance. He bases this contention on the fact that the City has already included an amount of $83,700 for fire hydrant maintenance on line 3, column 7 of Table 3-5, Revised Report on Water Utility Financial Plan and Cost of Service Rate Analysis. Mr. Buckley asserts that, until the City can clearly demonstrate that the amount of claimed omitted costs is not one and the same as the amount shown on table 3-5, it should be denied.

48. Testimony received during the hearing from City witnesses revealed that the City's accountants had inappropriately categorized $82,945 of fire hydrant maintenance costs as capital, as opposed to operating, in nature. The witnesses further indicated that the City's consultants relied

upon the accountant's categorization of these fire hydrant costs in developing the financial plan and included them on Appendix J of the Water Master Plan as capital maintenance costs. In its late filed exhibits the City has omitted these costs from the capital maintenance budget and included them as operational. The Commission, after reviewing the late-filed exhibits, is sufficiently satisfied that the Applicant is only attempting to recover fire hydrant maintenance costs once. Therefore, the Commission finds it appropriate to increase operation and maintenance expenses by $82,945.

49. Therefore, the Commission finds, based upon the preceding Findings of Fact, that the Applicant's net normalized test period operation and maintenance expenses are $2,647,870.

50. The Commission, based upon Findings of Fact contained herein, finds that the Applicant should be allowed to increase annual revenues by $1,351,145. This requirement is calculated as follows:

Operating Revenues	$3,645,600
Less:	
Operating Expenses	$2,647,870
Debt Service	1,877,100
Debt Service Coverage	471,775
Total Revenue Requirement	$4,996,745
REVENUE DEFICIENCY	$1,351,145

RATE DESIGN

51. The Commission, by separate order, will discuss the issue of cost of service and rate design in this Docket. The rate design order will be issued by the Commission no later than November 25, 1991.

MISCELLANEOUS

52. During these proceedings the City provided certain inaccurate financial and statistical information to the parties. It is the Commission's understanding that the source of the

inaccurate information was the City's finance/accounting department. The City needs to review its financial/accounting internal controls insofar as they relate to the City's public utility operations.

53. One of the concerns expressed by MPA was the possibility that water utility funds had been transferred to other funds thus necessitating the need for its increase. During its discovery audit of the books and records of the City of Great Falls the Commission staff found no indication of improper transfer of utility funds. The Commission is reasonably satisfied that the City has not used fund transfers as a basis for justifying an increase in utility rates.

DISCUSSION

The majority of the proposed capital improvements to be undertaken by the City are beyond the scope of this order and in all probability will not be subject to the scrutiny of this Commission. Increases necessary to fund prospective improvements will, in all probability, be the jurisdiction of the local government.

The public and MPA questioned the overall cost and necessity for capital improvements that are proposed to occur within the next 10 years. Witnesses indicated that they were concerned about the ability of consumers to pay for the aggressive long-term capital improvement program. The public should understand that the 10-year capital improvement program prepared and presented to the Commission will be subject to significant modification on a prospective basis. Prior to determining a need for additional capital improvements public policy and good management practices dictate that the planning document be reviewed and updated and that the consuming public has a meaningful voice in the decisions.

During this review process the City, through its staff and City Commission, should ensure that the proposed improvements are both necessary and cost-effective. Public involvement in the planning process should be sought and encouraged by the City to ensure the broadest base of involvement possible.

The City, in its deliberations on capital improvements, should be cognizant of the rate shock that will be experienced by subscribers, especially fixed and low income subscribers. One of the major concerns expressed during the hearing was the economic impact that implementation of increased rates would have on consumers. The Commission shares this concern and believes the City does as well. But, for the reasons outlined in this order, the Commission has found that the City of Great Falls must generate increased revenues from its consumers.

CONCLUSIONS OF LAW

1. The Applicant, the City of Great Falls, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's rates. Title 69, Chapter 7, MCA.

2. The Commission has provided adequate public notice and an opportunity to be heard as required by Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.

3. The rates and rate structure approved in this order are just and reasonable. Sections 69-3-201, and 69-3-330, MCA.

ORDER

THEREFORE THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. The revenue increase authorized herein is in lieu of, not in addition, to that authorized in Order No. 5523.

2. The City of Great Falls is authorized to issue revenue bonds in the amount of $7,050,000 with the requirements as outlined in Finding Fact No. 35.

3. The rates approved herein for the revenue bond issue shall not become effective until the tariffs, revenue bond ordinance(s), and necessary calculations relating to debt costs have been submitted for review by the Commission.

DONE IN OPEN SESSION at Helena, Montana, this 23rd day of September, 1991, by a 3 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

WALLACE W. "WALLY" MERCER, Commissioner

JOHN B. DRISCOLL, Commissioner

BOB ANDERSON, Commissioner

ATTEST:

Ann Purcell
Acting Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.•